

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER: 03-0015**  
**SALES AND USE TAX**  
**FOR TAX PERIODS: 1999-2001**

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**ISSUE**

**Sales and Use Tax: Manufacturing Exemptions**

**Authority:** IC 6-2.5-3-2 (a), IC 6-2.5-5-3, IC 6-2.5-5-5.1, 45 IAC 2.2-5-10 (c), 45 IAC 2.2-5-10 (h)(2), 45 IAC 2.2-5-12, *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983). *Rotation Products v. Indiana Department of State Revenue*, 690 N.E.2d 795, 803 (Ind. Tax. Ct. 1998).

The taxpayer protests the assessment of use tax on certain items of tangible personal property.

**Statement of Facts**

The taxpayer is in the business of manufacturing, repairing, and sharpening saw blades. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use tax, interest, and penalty. The taxpayer protested a portion of the assessment. At the taxpayer's request, this Letter of Findings is based on the documentation in the file.

**Sales and Use Tax: Manufacturing Exemptions**

The taxpayer's protest concerns its tax liability in the alleged rebuilding or remanufacturing of certain saw blades. The taxpayer's first step in the process is removing all carbide teeth by torch. A plate is put on the Nitshushita Saw Grinder to grind in new gullets. These new gullets are programmed into the grinding machine computer according to the saw blade application. Proper wheel width is determined for the gullet and secured to the spindle. After gulleting, the taxpayer establishes a new seat pocket for the new carbide tip. This is also completed on the computer controlled Nitshushita grinding machine. The seat pocket angle is determined by the application of the blade. This angle is programmed into the machine. The blade is then cleaned and is ready for brazing new carbide teeth. Next the plate is brushed with brazing flux. After determining size and grade of carbide tip, the tips are cleaned. Then the screws on the retipping table are adjusted to center tooth on the plate. The torch is lit and flame adjusted for the size of the carbide teeth. The teeth are placed into the new seat pocket. The torch is then brought to the tooth and brazes the tooth to the plate. After the complete brazing of the blade, it is left to cool. A shock test is done to several teeth to ensure proper brazing. After the cooling and shock test,

the teeth are inspected for the proper setting of teeth in the seat pockets. The rim of the saw blade is then sand blasted on both sides and the teeth are reinspected. The blade is put on a dual side grinding machine to grind in a new radial and tangential clearance angle. These angles are programmed into the grinding machine and are determined by the application. After the width (Kerf) of the saw blade is established, the blade is ready for top grinding. The application determines what top and back clearance angles are programmed into the grinding machine. After the top grind is completed, the face grinding begins. The teeth are face ground parallel to the back of the seat pocket. This angle is programmed into the grinding machine. After the blade passes the final inspection, the blade is dipped into a protective plastic coating. The department's audit assessed use tax on many items used in this process. The taxpayer protested the assessment of use tax on the items it used in this process.

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. There is no exemption available for tangible personal property used in the provision of a service.

A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication . . . of tangible personal property." (the equipment exemption) In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production. 45 IAC 2.2-5-10 (h)(2) further clarifies the exemption by allowing the exemption of "Replacement parts, used to replace worn, broken, inoperative or missing parts or accessories on exempt machinery and equipment . . ." IC 6-2.5-5-5.1 provides for the exemption of tangible personal property ". . . if the person acquiring the property acquires it for the direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, . . ." (the consumption exemption) Pursuant to 45 IAC 2.2-5-12, consumption of tangible personal property in the direct production process means "dissipation or expenditure by combustion, use, or application.. ." of the tangible personal property in an "essential and integral part of an integrated process which produces tangible personal property."

Both the equipment and consumption manufacturing exemptions require that the subject item be used in a production process. The taxpayer contends that the protested items qualify for either the equipment or consumption exemption. The department assessed use tax on the protested items because the department determined that the items were used in the service of repairing saw blades rather than a true production process. The first issue to be determined here is whether the protested items were actually used in the provision of a service or in a production process as the taxpayer contends.

To support its contention that the taxpayer is actually remanufacturing the saw blades in a production process rather than providing a repair service, the taxpayer cites *Rotation Products v. Indiana Department of State Revenue*, 690 N.E.2d 795, 803 (Ind. Tax. Ct. 1998). In that case, Rotation Products Corporation successfully argued that it took raw materials in the form of unusable roller bearings and created an entirely new product, i.e., the remanufactured roller bearings. The Court found that this was a production process and not the provision of a service.

To reach this conclusion, the Court instituted the following four-prong test to distinguish a production process from the provision of a service. First, a production process must be complex and substantial and produce a different end product. Secondly, the property must become more valuable in the process. Thirdly, the end product of the process must compare favorably with newly manufactured articles of its kind. Finally, the process must not be part of the normal life cycle of the original product.

First, like the taxpayer in *Rotation Products*, this taxpayer performs substantial and complex work and significantly changes the saw blades. When received, the blades are unusable and unable to be sharpened. They are in worse shape than a “blank” which is the raw material purchased for manufacturing. The previous recitation of the steps involved in the process indicate the substantial and complex changes the taxpayer makes in the saw blades.

Secondly, the property must become more valuable in the process. The taxpayer takes nonusable saw blades and transforms them into marketable saw blades. Before the remanufacturing process, there is no market for the saw blades except possibly as scrap metal. After the remanufacturing process, the saw blades are a functional and marketable product.

The taxpayer guarantees its customers that the processed saw blades are as good as and often better than a new saw blade. The blades receive all new carbide tips as in the accepted manufacturing process for new blades. The blades are also computer precision sharpened like new blades. Therefore, the performance of the new saw blade is as good as a new saw blade.

Finally, the taxpayer’s processing of the saw blades is not part of such property’s normal life cycle. In *Rotation Products*, the Court noted that even if the cleaning and polishing of bearings is routine maintenance that is a normal part of such bearings’ lifecycle; grinding bearing surfaces and replacing roller cages and elements are not. *Id.* at 803-04. Similarly, the taxpayer’s replacement of the tips, angling of the tips, and computer grinding and sharpening is significantly more than the mere cleaning and sharpening in the normal lifecycle of a saw blade.

Since it has been determined that the taxpayer actually produces a marketable product in a production process, the second issue is to determine whether the protested items actually qualify for the equipment and consumption manufacturing exemptions. The taxpayer’s explanations of the use of the items in the production process indicate that they qualify for either the equipment or consumption manufacturing exemption.

### **Finding**

The taxpayer’s protest as to the equipment and materials used in the remanufacturing of saw blades is sustained.